Nationalisation of royal bank of scotland

Finance, Banks

Purpose

The purpose of this report is to discuss the change in Royal Bank of Scotland indicated by the company's nationalization in 2008. Shareholders lost the most part of the company in favour of the government and management of the bank had to be changed. The purpose will be fulfilled by analyzing the process of nationalization and its implications for RBS.

Theoretical literature provides a lot of models of change management and strategic management. For example, Ansoff (1987) model suggests four quadrants of strategy. Companies can grow by penetrating the market and winning larger market share while competitors share will shrink. Firms can also develop their key products which are their strength and this will be a strategy for expansion. The third Ansoff's (1987) strategy would be to diversify the products and operations to achieve growth. Finally, the company can choose to pursue market development which is entering new geographical areas or new niches that will help generate higher revenue. The case of RBS represents this final model of market development. The banks pursued the new market of mortgage backed securities in the US through acquisition of ABN Amro. This strategy appeared to be unsuccessful and led the bank into a position where accounting losses reached tremendous value of over 30 billion pounds in 2008 and led to nationalization of the bank by the UK government.

Company Overview

Royal Bank of Scotland Group plc is a banking corporation with its branch – Royal Bank of Scotland (RBS) that is spread around United Kingdom with almost 700 sub-branches, located in Scotland, England and Wales and is one of the largest banks in UK. It was founded in 1727 and is the first bank introducing overdraft availability to its clients. Since its foundation, RBS expanded greatly, with big number of acquisition deals, such as its acquisition of NatWest Group in 2000, First Active (Ireland), Charter One (USA) , Churchill Insurance (UK) and ABN Amro (Netherlands) in 2007 (House of Commons Treasury Committee, 2008).

The Royal Bank of Scotland still uses a privilege of printing its own banknotes. Until 2009, it was one of the main shareholders of the Bank of China, but had to sell its shares after the global financial crisis impact. RSB is still in the list of world’s largest banks, being on 6th position in 2003, 10th in 2007 and 19th in 2008 (Financial Ranks Online, 2009).

Financial performance of RBS was changing in the last years. In 2005 group operating profit rose by 16%, with total dividend for the year increase by 25%, with capital and earnings increase. During 2006, RBS showed great results and continuing growth, with increased dividends by 25% with total income growth by 10%. With unstable position in the market and in global financial system, RBS had some problems, but managers were working toward control of the situation, however growth of the operating profit decreased by 9%, earnings per share by 18% and return on equity – 19. 9%. The company faced big net losses of around 7. 9 billion pounds. In the 2009 bank entered hard times with reorganization in management field and in structure. (RBS Annual Report, 2005-2009).

Due to changing situation in the global economy, in 2008 Royal Bank of Scotland announced its greatest loss in the bank's history with the amount of 692 million pounds that was connected to unhealthy loans and 71 billion pounds as a result of incorrect deal of acquiring ABN Amro (Bradley, 2009). Prior to the global financial crisis RBS have had great profit margins and was a respected brand with long history. And it is necessary to mention that the bank was at great position in terms of facing crisis, with little impact until the decision of getting ABN Amro, which brought various problems.

In 2008-2009 UK citizens were under shock of the fact that one of the largest UK banking system representatives had incredible losses and unpredictable future. At this position RBS had one way to survive – seek government support. However not all UK banks suffered from consequences of global financial crisis, which can be connected with accurate and carefully planned management strategy. RBS have got some capital of about 2 billion pounds from selling its share in Bank of China and after giving up part of Linea Directa, a Spanish insurance company for about 4. 5 billion pounds. However, it did not help to make a radical change of the situation (Bradley, 2009).

According to Hester, current Chief Executive of the RBS Group (2009), great losses of the Group had nothing to do with management of businesses as their performance was profitable. However problems appeared mainly in two divisions – Global Banking & Markets and Asia Retail & Commercial Banking. Their profits were crushed by market and credit losses, within fast changes in the economic conditions. At the same time top managers of the Royal

Bank of Scotland were facing risks of acquisition and had limited time to make decisions. Global financial crisis had its impact in different countries, affecting economies and markets especially in terms of exchange rates. Here, decrease in sterling exchange rate had an influence on further performance of the bank and changing market position intensified the situation (Hester, 2009).

In spite of the fact that financial situation became critical for many banks, RBS was still having serious and stable business. Top management was taking steps to recover from crisis consequences, in order to return capital and provide stable ground for future operation such steps included applying to government support. The strategic plan for recovery was supposed to be finished in 2009, meanwhile the focus is on long-term customer franchises, quality and profitability.

Royal Bank of Scotland can be an example of the fact that in terms of global financial crisis even big and powerful organisations can face danger. It is the biggest UK company that suffered from the global economic crash. Today it is still far from recovery, having bad loans and loss before tax in the beginning of 2009 was around 44 million pounds. From the forecasts, 2009 and 2010 will still be challenging for the RBS with main focus on debt returns. Now, after current management revision, directors of RBS are more confident of future recovery and success (The Telegraph, May 2009). New Chief Executive supports the position that management must stay calm and take steps for a slow but effective recovery, rather than fast and wasting strategies in order to save more that to spend (Murchie, 2009).

However, human resource management of the bank is not so confident and planning to shorten around 9000 jobs, which is about 20%. It is believed that this action will help to decrease costs of around 3 billion dollars (Global Crisis News, 2009). Moreover, RBS represented the worst results in the market, being at the bottom of banking sector in September 2009 (Frei, 2009).

Aspects of Nationalisation

According to Encyclopedia Britannica, nationalisation is " alteration or assumption of control or ownership of private property by the state" (Encyclopedia Britannica, 2009) with several variations in the types and motives. Nationalisation usually appears through assets or shares taken over, and this can help the company to continue its business but under control of the government. If the company is nationalised by government it can continue to produce and operate, getting some revenue and have some returns on shares. Usually this process is followed by structural reorganisation, including traditional administrative strategy and style of control (Backhaus and Wagner, 2004).

As a fact, nationalisation can come in the form of expropriation, if the previous owners do not get compensation for the business and in the form of rescue tool or governmental support. Not every company can get such support; it is usually a privilege of the companies and corporations that have national importance and heritage. There is a number of examples in the UK history of nationalisation, which helped to reorganise the structure of the company as well as to get financial support (Floud and McCloskey, 1994). It is believed that nationalisation started in the UK in 1908 after the establishment of Port of London Authority with the necessity of production control (Beardshaw and Ross, 2001).

Some researches mention negative effects of nationalisation, pointing that it can damage economy and banking sector. One of the problems is decreasing competitiveness, especially in banking sector (Lee, 2007). Also, financial institutions and government avoid participating in management as it can lead to further recalls of nationalisation. And when the company fails to use management as an appropriate tool, the chance of mistake gets bigger with a cause of future nationalisation (Cuthbert and Dobbins, 1980). Mainly, nationalisation has political or economic aspects and motives. When government has power to control specific corporations and their production as well as financial position, it can use the company as an instrument to correct economy. In addition, government can provide more accurate and efficient capital and assets diversification.

If the company is fully nationalised, government becomes the owner of the business and has to deal with its problems and debts. Nationalisation is connected to economy, here in order to have more attractive economy, government trying to stabilise financial system through bad assets escape. There are still debates around the necessity of nationalisation and its problems. On the other hand, there is a view that this process must have temporary term, and government acts more as guardian of the company or bank for the hard period. However, one must consider that the process of nationalisation must be done correctly and carefully, with revision of all advantages and disadvantages (Richardson, 2009).

Looking at the advantages of the nationalisation first comes its ability to save the company or in our case the bank from heavy and senseless assets, which were collected over the time and are representing thread of bankruptcy. This will include separation such assets from the business allowing operating more efficiently. Unnecessary assets then can be put for sale or managed by another organisation and the bank, free from problematic sectors can continues to operate. In addition, nationalization can help to restructure top management, getting rid of dilettantish approach of operating the business (Richardson, 2009). RBS is also supporting this fact and according to Montia (2009), is now selling some of its asset management business with managed capital of 30 billion pounds. In addition, it is possible that RBS will have to sell more of its business and even at the very low price that is now at the market. It is also a part of the Chief Executive's recovery plan for the RBS – to separate troubled divisions from working ones with further selling of non-core parts of the business (Bradley, 2009).

Without considering the advantage of nationalisation, government can continue to give money support to the banks that are big and important for the economy, but this can create the situation, where nothing will be changed and achieved. Government support can give a privilege of a competitive advantage, for example, Northern Rock could cut its prices in mortgages and insurance and attract new customers.

Among disadvantages of nationalisation is management problem. In reality it is very difficult to find right and appropriate human capital for each bank in order to manage them properly. Still there will be a chance of risks regarding new borrowings, credits and market position. And these risks are now to be taken by the owner. Again the problem of unnecessary assets appears and banks need to get rid of then, basically on very low prices. In this situation market will have clear advantages of nationalisation, while banks will suffer. In addition, nationalisation is very challenging to the government. It must find labor force and money to finance the process. Future performance of the company also depends on who will be in charge – could be government itself or another managing company (Richardson, 2009).

In order to avoid afterward problems, other options and decisions must be revised before the final decision of nationalisation. The company must stay efficient and respond to the market and global changes in time. Management must stay open and react quickly in order to avoid critical point.

Change Process: Nationalisation of RBS

In the beginning it is important to discuss global economic situation which caused problems in RBS and necessity of taking radical directions, including nationalisation. UK banking sector was under pressure of economic crisis 2006-2009 and is still recovering. It all started from the US sub-prime mortgage crisis and reached the rest of the world at the beginning of 2007 with increasing debts. Most of all crisis hit banking sector, central banks and international banks worldwide. As a result the Bank of England had to decrease interest rates, and all banks were under risk of failure (Rayner, 2008).

Current crisis was named the worst for the last 75 years with negative effects on many types of businesses and customer's expectations (Altman, 2009). During this time period management was facing great challenges, especially risk management. In addition, it is obvious from current crisis practice that risk management can help to win the race and using various models and strategies matters (Varma, 2009). Spreading from United Stated over Europe and UK crisis attacked banking sector. UK's economy is connected to the US through trade and loans and borrowings. As a result of the continuing bankruptcy of banks, some tried to avoid it through help request from government. The first bank that was fully nationalised in UK is Northern Rock, followed by the Lloyds Banking Group with partial control from the government.

Some researchers put nationalisation under meaning of rescue, and as a fact not all banks or companies were getting such rescuing package from the UK government. In the case of Northern Rock, decision was made according to the point that this bank is special and its failure can cause growing instability in the UK banking sector (Tomasic, 2008). This also can be true about the Royal Bank of Scotland as it is bank with great history, representing Scottish nation as part of Britain, with its own printed banknotes and heritage. In spite of the fact that many banks across the world were put into critical situation, having choices of selling just assets or banks itself, not many were rescued (Woods, Humphrey, Dowd, Liu, 2009).

In the report of the House of Commons Treasury Committee (April, 2008) it is discussed that in October 2008 RBS introduced new plan of rescue with capital amount of 20 billion pounds, however, shareholders were getting unattractive returns and government had to rescue RBS through acquisition of major part of its shares. At that time point nationalisation was inevitable in relation to future life of the RBS. Looking at the managerial problems that caused such consequences it can be pointed that RBS’s top management along with its prior Chief Executive, Sir Fred Goodwin was taking over optimistic decisions as well as misunderstanding of the critical situation.

Wrong decisions were made due to fast process of the economic worsening in UK and globally. According to Hester, RBS was suffering from great downturn due to prior decisions. In addition wrong risk management strategies that were adopted at that time made even worse, in particular control issues. It seems that RBS had a great balance sheet for a long time period and was not prepared for immediate change. In 2007, RBS made a crucial decision of taking over ABN Amro bank, in cooperation with Fortis and Santander banks, this resulted in RBS’s independence of private organization. Acquisition of the ABN Amro was a wrong step to take in the thread of economic crisis which made RBS unable to finish its strategic plan. Newly formed group was defenseless in the worsening situation of market changes (House of Commons Treasury Committee, 2008).

The step of huge expenditure, acquiring ABN Amro in wrong time, could have been avoided by managers of RBS. Even more, loss of around 72 billion Euros intensified critical situation. Managerial decisions of this acquisition were made without disclose of credit and asset problems in ABN Amro prior to the deal. In addition, this decision was influenced by shareholders, here

94. 5% of them agreed on acquisition and it may appear that they pressed top management to finish the deal. However, RBS directors and top managers agreed about the deal with unanimity. Consequence of this deal is big loss in 2008 of around 30 billion pounds instead of assumed profit. The change associated with acquisition of ABN Amro was a representation of Ansoff's (1987) market development strategy. RBS attempted to expand into the US market geographically and in addition the company attempted to profit from dealing with US mortgage backed securities. However, the failure of the strategy caused the banks to suffer losses and request the help from the government which acquired the shares of the business.

The process of nationalisation of the RBS began with basic rescue program. In October 2008, RBS started new strategic program in order to increase capital. One of the solutions was to offer ordinary shares at a price of 65. 5 pence per share. The offer consisted shares for 15 billion pounds. HM Treasury has got around 12% for 5 billion pounds and later on around 57. 9% of shares were acquired by the Government. Decisions that were made by RBS and Government were directed to the achievement of more stable bank position and additional resources for strength and further capital enlargement. Government and the bank deny that there was a strategy of total nationalisation and when financial position of RBS will be stable, it will again be under private ownership (Webster, 2008).

It can be argued that this nationalization is an example of emergent change rather than planned strategy (Whittington, 1993). Emergency was caused by the high dependency of the bank on the inflow of cash for sustaining its operations. Whittington (1993) proposed four basic approaches to strategy. These can be classified as classical, systematic, evolutionary and processual. Classical approach suggests that the company's strategy would be to maximize profit. Evolutionary approach suggests that the environment will select the strongest businesses. The systematic approach suggests that social environment will determine business strategy. The change in RBS is processual because it implies that the company consists of different stakeholders who have their own interests and ambitions. The goal of the management is to satisfy the interest of each stakeholder. If RBS was not nationalized and this changed was not made, the society, employees and even shareholders would suffer negative effects. However, it can be argued that the nationalization might have hurt shareholders even more because the value of their equity has gone down as the share price plummeted.

PEST Analysis of RBS

The change in the organization connected with the process of nationalization can be reflected in the PEST analysis of the company:

Political Factors

– The Ownership of the bank is changed in favour of the UK government;

– Bail out was done out of the UK government budget;

– Support of the government will have positive effects on financial matters;

– Government's support will cause managers to act in the interests of the government rather than shareholders.

Economic Factors

– Interest rates declined; so demand for lending can rise;

– Financial Crisis in the UK and the world may further deteriorate performance of the banks and additional capital may be required from the government.

Social Factors

– The change in the bank is also connected with restructuring of the company and lay offs;

– Rising unemployment is a negative consequence of business failures such as RBS.

Technological Factors

– Technologies are constantly improving and this facilitates the banking business of RBS because some costs are being reduced and the work is being optimised;

– However, since the ownership of the company changed from shareholders to the government, management will be rather interested in meeting the objectives of the government rather than optimising the work with new technologies.

Conclusion

Royal Bank of Scotland is now almost entirely owned by British government – around 70%. Today, RBS is among first banks to enter new program named asset protection plan. In 2009 RBS had suffered of worst loss of about 24. 1 billion pounds and adopted plan of survival. Some analysts point that as the

RBS is not fully nationalised it can still face the risks and fail to satisfy investor's expectations. As resent investor's rate increased with great returns there is number of requests to have RBS fully nationalised (Werdigier, 2009).

It is hard to judge whether RBS could have avoid nationalisation in the situation when it is hard to turn back and see other choices. However, there were some managerial mistakes that could have been avoided. Poor change management was not ready to face difficulties and get over them. Besides the acquisition of the ABN Amro that was already discussed, there was another managerial mistake of continuing dividend increase after the change in earnings that were decreasing. Trying to attract new investors with high dividends and please current shareholders, management put the business under risk of failure. After the ABN Amro deal, this, along with unhealthy assets that were not sold in time had lead RBS to the final step of nationalisation.

Being attractive for investors and shareholders for a short time period RBS created consequences where investors of the company became most affected by nationalisation. Prior to the crisis RBS was a profitable company with attractive position. Later on there was a decrease of the UK shares market and dramatic drop in RBS share prices.

Overall at the point that RBS entered in 2008, nationalisation seems to be the last chance of survival. It can give some extra time to make new strategic plan and to recover from the financial instability. There is still a chance for RBS in the future to become profitable, independent and private company.

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